

Message Text

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63

ACTION ARA-20

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-07 PA-04 RSC-01 PRS-01 SP-03 SS-20

USIA-15 AID-20 COME-00 EB-11 FRB-02 TRSE-00 XMB-07

OPIC-12 CIEP-02 LAB-06 SIL-01 OMB-01 AGR-20 SWF-02

STR-08 DRC-01 (ISO) W

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R 092230Z MAY 74

FM AMEMBASSY QUITO

TO SECSTATE WASHDC 1000

INFO AMCONSUL GUAYAQUIL

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E.O. 11652: N/A

TAGS: ECON, EC

SUBJECT: INFLATION: FROM BAD TO WORSE

REF: QUITO A-32

SUMMARY: CONSUMER PRICES ROSE AT AN ALARMING ANNUAL RATE OF 54 PERCENT IN FIRST QUARTER 1974. AGRICULTURAL STAGNATION AND GOE POLICIES HINDERING FOOD IMPORTS WERE THE MAJOR CAUSE ON THE SUPPLY SIDE, AND AN INFLATED GOVERNMENT BUDGET ON THE DEMAND SIDE. IN RESPONSE, THE GOE LARGELY ABANDONED AGRARIAN REFORM AND ITS LONG STANDING POLICY OF ARTIFICIALLY LOW AGRICULTURAL AND FOOD PRICES. IN ADDITION, THE GOE SOON MUST FACE THE ISSUE OF WAGE POLICY. END SUMMARY.

1. CONSUMER PRICE INDEX (CPI) FOR MARCH REVEALED OFFICIALLY THAT DURING THE FIRST QUARTER OF 1974 ECUADOR SUFFERED A PHASE OF GALLOPING INFLATION. DURING THIS PERIOD THE INDEX CLIMBED 11.4 PERCENT, WITHOUT RIVAL THE WORST THREE MONTH PERIOD SINCE THE CPI WAS ESTABLISHED IN 1951. FOOD, UP 16.8 PERCENT, LED
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THE SURGE IN PRICES. WITH THE CAVEAT THAT SEASONAL FACTORS IN

AGRICULTURE AND HEAVY YEAR-END GOVERNMENT EXPENDITURES MAKE INFLATION WORSE IN THE FIRST QUARTER OF MOST YEARS, THESE INCREASES REPRESENT ANNUAL RATES OF 54 PERCENT OVERALL AND 86 PERCENT FOR FOOD.

2. AS THE CPI INDICATES, AGRICULTURAL STAGNATION REMAINS AT THE ROOT OF THE PROBLEM. MANY BASIC FOODSTUFFS WERE IN SHORT SUPPLY, CAUSING LONG LINES OUTSIDE STATE-OWNED SUPERMARKETS SELLING SMALL AMOUNTS PER CUSTOMER AT OFFICIAL PRICES, WHILE PRICES BALLOONED FAR ABOVE OFFICIAL LEVELS AT NEIGHBORHOOD STORES. THE SITUATION HAS RECEIVED CONSTANT PUBLICITY, PARTICULARLY IN THE GUAYAQUIL PRESS. MUCH OF THE BLAME CAN BE LAID TO THE GOVERNMENT POLICY OF ARTIFICIALLY LOW CONSUMER AND PRODUCER PRICES, MAINTAINED TO THE END BY FORMER MINISTER OF AGRICULTURE GUILLERMO MALDONADO. LOW PRICES HELD DOWN PRODUCTION, ENCOURAGED LEGAL AND ILLEGAL EXPORTS, AND MADE IMPORTS UNPROFITABLE; MOREOVER, THEY FAILED TO BENEFIT THE CONSUMER, WHO WAS GOUGED ANYWAY BY SMALL SHOPKEEPERS.

3. THE SEVERITY OF THE AGRICULTURAL SITUATION LED THE GOE TO TAKE TWO VITAL DECISIONS IN MARCH: A) OFFICIAL PRICES TO PRODUCERS AND CONSUMERS FOR SIX BASIC FOODSTUFFS WERE RAISED SHARPLY, ALTHOUGH THE GOE DID NOT MOVE TO A FREE MARKET; AND B) AGRARIAN REFORM WAS PUT ON A BACK BURNER SO AS NOT TO DETRACT FROM INCENTIVES TO GREATER INVESTMENT AND PRODUCTION. MINAG MALDONADO, A PROPONENT OF LOW PRICES AND AN ENTHUSIASTIC SUPPORTER OF AGRARIAN REFORM, RESIGNED TO MAKE WAY FOR THESE POLICIES. NEVERTHELESS, OFFICIAL CONSUMER PRICES OF THESE ITEMS WERE NOT RAISED HIGH ENOUGH TO MAKE PROFITABLE PRIVATE IMPORTS TO RELIEVE SUPPLY PROBLEMS, AND PRODUCTION INCENTIVES INEVITABLY REQUIRE TIME TO TAKE EFFECT. THUS THE SHORT RUN PROBLEM HAS NOT BEEN SOLVED.

4. GOVERNMENT EXPENDITURE GAVE THRUST TO ACCELERATING INFLATION SECOND ONLY TO SCARCITIES OF FOOD. CENTRAL GOVERNMENT SPENDING IN NOVEMBER AND DECEMBER 1973 WAS 51 PERCENT HIGHER THAN THE SAME MONTHS OF 1972, AND SPENDING IN 1974 MAY EXCEED 1973 BY 35-45 PERCENT. EFFORTS BY MINISTRY OF FINANCE AND OTHER OFFICIALS TO CONTAIN GOVERNMENT SPENDING HAVE REPEATEDLY MET ONLY PARTIAL SUCCESS.

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5. IN VIEW OF THE PRACTICAL IMPOSSIBILITY OF HOLDING DOWN GOVERNMENT SPENDING OR OF INCREASING AGRICULTURAL PRODUCTION SWIFTLY, THE TASK OF COMBATting INFLATION BECOMES FRUSTRATINGLY DIFFICULT. POLICY MAKERS HAVE DONE WELL TO FOSTER IMPORTS, BUT WITH THE KEY EXCEPTION OF FOODSTUFFS. THE GOVERNMENT HAS CAUSED ITSELF GREAT DELAYS IN EFFORTS TO SUBSIDIZE IMPORTS OF WHEAT AND TO OBTAIN RICE ON ITS OWN ACCOUNT FOR SUBSIDIZED SALE,

AND THE SAME POOR MANAGEMENT IS LIKELY TO INTRUDE IN THE CASE OF INCREASINGLY SCARCE VEGETABLE OILS. IN ADDITION, THE GOE NOW FACES A REAL DILEMMA IN THE AREA OF WAGES. IN ITS DECEMBER 1973 AND MARCH 1974 ANTI-INFLATIONARY PACKAGES, THE GOE GRANTED LITTLE BY WAY OF WAGE INCREASES, BUT IT DID ESTABLISH A MECHANISM FOR REVIEWING AND RAISING WAGES ON A SECTORAL BASIS. IF INFLATION CONTINUES AS IN THE FIRST QUARTER, THE GOE MUST EVENTUALLY YIELD CONSIDERABLE GROUND ON THE WAGE FRONT, KNOWING FULL WELL THAT ONE CONSEQUENCE WILL BE MORE INFLATION.

6. COMMENT: THE GOE HAS BEEN REMARKABLY FORTUNATE THAT NEITHER LABOR NOR POLITICIANS HAVE HAD THE STRENGTH TO ORGANIZE EFFECTIVE OPPOSITION TO THE GOVERNMENT ON THE INFLATION ISSUE. HOWEVER, THE PUBLIC CANNOT BE EXPECTED TO TOLERATE 80 PER CENT INFLATION IN FOOD PRICES INDEFINITELY, AND THE GOE WILL HAVE TO MOVE ON WAGES OR FOOD IMPORTS, OR FIND ANOTHER INSPIRATION BEFORE LONG. SECOND AND THIRD QUARTER PRICE INCREASES WILL PROBABLY NOT BE AS ALARMING AS IN THE FIRST QUARTER. ON THE OTHER HAND, AN IMPROVEMENT SO GREAT THAT THE GOE CAN AVOID ANOTHER MAJOR DECISION REGARDING INFLATION SEEMS ONLY A REMOTE POSSIBILITY.
BREWSTER

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